

Article topic: Financial Management

December 2009

Taking a fresh look at your finances

With next year's Budget and General Election on the horizon, the subject of personal tax is set to be top of the agenda. With this in mind, we are advising clients to act now to get their tax affairs in order. Here are just a few of the tax planning ideas some of them are now benefiting from.

1. Property

Capital Gains Tax

Individuals can only have one Principal Private Residence (PPR) at one time and married couples only one PPR between them. Any capital gain arising on your PPR is not subject to Capital Gains Tax. Generally, a second home or city flat is subject to Capital Gains Tax, currently at 18%. With careful planning and elections it may be possible for the capital gains on the second home to be mitigated. Timing is essential and expert tax advice should be sought sooner rather than later. It may also be possible to convert 40% tax on an old gain to 18%.

Income Tax

HMRC have widened their definition of 'qualifying loan interest' on rental properties. As a result we can now potentially claim tax relief on up to 100% of value of the rental property on the date it was first let. Anyone with a mortgage on their main home and a rental property could be paying too much tax each year and potential tax savings could be significant.

Inheritance Tax

Rental properties with significant capital gains attached to them could be transferred to a Discretionary Trust. This can save future Inheritance Tax and is particularly attractive when property values are low. Any Capital Gains Tax on the transfer can be held over and the trust will pay the tax on the sale of the property at a later date.

2. Tax mitigation

Enterprise Zone Trusts (EZTs)

It is possible to acquire a share in a commercial property, funded by a combination of tax savings and borrowing where taxable income is expected to be in the region of £140,000 in the current tax year.

For every £100,000 of loss needed by a taxpayer, an initial contribution of £40,000 is required - the balance is loaned to the taxpayer as part of the structure. The loss will then generate tax savings of just under £40,000 for higher rate taxpayers in 2009/10, leaving the taxpayer virtually tax neutral. Rental income from



a lease will service the loan. After seven years the property can be sold and the equity released to the investors, usually free of Capital Gains Tax.

Film Partnerships

Your higher rate tax can be used to fund an investment in a film partnership, where you can share in the commercial success of films, such as *St Trinians 2*. An initial cash outlay of £10,000 would lead to a tax saving of £10,000 for a higher rate taxpayer, meaning that you are effectively cash neutral in the first year. This may be suitable for taxpayers with over £65,000 of taxable income in 2006/07, 2008/09, or 2009/10.

Active Partnerships

There are a variety of opportunities available whereby higher rate tax can be recovered to effectively fund a contribution to a trading partnership. Typically, income levels need to be in excess of £150,000 in at least one of the tax years from 2006/07 to the current tax year. In some instances these leave you cash positive in the first year, with the ability to benefit from the ongoing commercial success of the business. You are likely to need to dedicate a small amount of time to being involved with the business in the first few months.

3. Inheritance Tax Planning

Wills

The starting point for any Inheritance Tax (IHT) planning is to ensure that Wills are structured correctly from a tax perspective. It is important that Wills are flexible enough to continue to be valid in the event of ever changing tax legislation.

Wills should also be reviewed and updated to suit current circumstances to ensure assets are directed as intended and protected, where necessary, and that children are provided for.

Trusts can be used to receive the residue of the deceased's estate on the first death. This will provide the executors with opportunities to carry out further planning after the first death to significantly reduce the amount of tax liable to tax on the second death. All this can be done whilst still providing the surviving spouse with access to the funds.

Planning is also needed to ensure that any assets that qualify for Business Property Relief are dealt with correctly to ensure that IHT does not arise on the value of these assets in the future.

Lifetime planning

Individuals with significant estates chargeable to IHT should consider lifetime planning to reduce their exposure to IHT, whilst maintaining control over their assets. Typically, this would involve the creation of trusts.

An amount up to the current available nil rate band can be settled into a Discretionary Trust, with no charge to IHT. This would deliver a considerable saving, provided they survive seven years after making the gift.

A couple could transfer assets up to a value of £650,000 between them. After seven years the nil rate band is available in full again to settle further assets, if needed.

The Discretionary Trust can be used to fund future planned expenditure on children or grandchildren. Depending on the ages of the beneficiaries and their relationships to the settler there can be additional Income tax benefits in distributing funds to the beneficiaries if their marginal rate of tax is lower or even 0%.

For more information on personal tax planning issues, please speak to our Financial Management team.

